CORRECTED MINUTES

TAX EXEMPTIONS INTERIM COMMITTEE

Joe R. Williams Bldg., East Conference Room, Boise, Idaho
August 1, 2007

The meeting was called to order at 9:02 a.m. by Co-chair Senator Brent Hill. Other committee members present were: Co-chair Representative Dennis Lake, Senator Joe Stegner, Senator Tim Corder, Senator Lee Heinrich, Senator Jeff Siddoway, Senator David Langhorst, Senator Diane Bilyeu, Representative Gary Collins, Representative Jim Clark, Representative Mike Moyle, Representative Dell Raybould, Representative Nicole LeFavour, and Representative Bill Killen. Staff members present were Mike Nugent, Eric Milstead and Jennifer O'Kief.

Others present included: Jack Lyman, Idaho Mining Assoc.; Skip Smyser and Scott Pugrud, Connolly & Smyser, Chtd.; Jeremy Pisca, Evans Keane, LLP; Jim Farrel, AARP; Bob McQuade, Ada County Assessor; John Watts, Veritas Advisors; Bibiana Nertney, Idaho Department of Commerce; Mike Huntington, Intermountain Gas Co.; Robin Nettinga, Idaho Education Assoc. (IEA); Woody Richards, Property Casualty Insurers Assoc. (PCIA); Daniel Chadwick, Idaho Association of Counties (IAC); Ron Snell, National Conference of State Legislatures (NCSL); Jeff Youtz, Director, Legislative Services Office; Russ Hendricks, Farm Bureau; Dan John, State Tax Commission; Judith Brown, Idaho Center on Budget & Tax Policy, United Vision for Idaho; Charlie Brown, Retired Educators Assoc.; Ray Houston, Legislative Services Office; Alex LaBeau and Mark Dunham, Idaho Association of Commerce & Industry; Paul Jackson, Farmers Insurance; Randy Nelson, Associated Taxpayers of Idaho (AIF); Tom Ryder, J. R. Simplot Company; Lynn Young, AARP-Idaho; Dr. Stephen Cooke, University of Idaho, Department of Agricultural Economics & Rural Sociology; Toni Lawson, Idaho Hospital Assoc. (IHA); Don Wimberly, Boise State Radio; Ron Williams, Idaho Cables Consumer Owned Utilities; Betsy Russell, The Spokesman Review; Norm Semanko, Idaho Water Users Assoc.; Steve Ahrens, Steve Ahrens Custom Communications; Brent Olmstead, Milk Producers of Idaho; Lloyd Knight, Division of Financial Management (DFM); Dawn Justice, Idaho Bankers Assoc.; Justin Ruen, Terry Mason and Leon Duce, Association of Idaho Cities; Mayor Nancy Merrill, City of Eagle; and Mayor Garrett Nancolas, City of Caldwell.

Senator Hill said that this committee was authorized under SCR119. He read from the resolution as follows: "Whereas the state's current tax system includes the income tax on individuals and corporations, sales and use tax on taxable sales and property tax on real and personal property." The charge of this committee is to "Undertake and complete a study of the state's tax exemptions, deductions and credits in all of their aspects and to make recommendations for a strategy to statutorily limit exemptions, deductions and credits more specifically to the uses of which the exemptions, deductions and credits were originally intended."

*Correction - page 3, Senator Heinrich's comment to repeal property taxes was corrected to read "personal property taxes. Senator Siddoway's agreement with Senator Heinrich was also changed to read "personal property taxes."

Senator Hill said that almost every exemption or credit requested has been granted. The original sales tax in 1965 had seventeen exemptions. There are presently over eighty. Thirteen business tax credits have been added to the income tax code. Each of those credits requires completion of a separate form to calculate the credit. We have become a fairly complex tax system by adding exemptions, credits and deductions.

Senator Hill commented that he is not against exemptions, deductions or credits. However, he gave a few reasons why they may not be the best choice. One is that some view tax cuts as good regardless of whether they are fair and equitable or whether they make good tax policy. Providing a tax cut to one taxpayer merely shifts the burden to others. Eventually, as more tax cuts are allowed, the tax rate will be raised on everyone. The other reason is that the tax break to one organization or industry is huge and the shift to the taxpayer is very small which is why they are so easy to grant. **Senator Hill** commented that his objective is to find out if these tax cuts are fulfilling their original intent and if they are proving to be fair and equitable to the general taxpayer. He said that if some of these tax cuts would be phased out, his purpose would only be to reduce the overall tax rate for everyone.

Senator Hill provided a handout entitled, “What Constitutes Good Tax Policy,” prepared by the American Institute of CPA’s, suggesting these would be good principles to follow as the committee moves through the process. A copy is available at the Legislative Services Office. He highlighted the following ten principles: Equity and Fairness, Certainty, Convenience of Payment, Economy in Collection, Simplicity, Neutrality, Economic Growth and Efficiency, Transparency and Visibility, Minimum Tax Gap and Appropriate Government Revenues.

Representative Lake remarked that the intent of the committee would be to review the current tax policy and determine whether some significant tax changes should be made. **Representative Lake** said that he and **Senator Hill** had previously discussed requiring a 2/3 majority for any recommendations this committee may make. **Representative Lake** suggested that a motion be made to require a 2/3 majority vote. **Senator Hill** said that only a simple majority is required to require a 2/3 vote on recommendations made by the committee. **Representative Lake** recognized and thanked **Representative Raybould** for filling in for **Representative Bedke** who was unable to attend.

Senator Hill invited the members to express any comments they may have regarding their expectations and goals for this interim committee. **Senator Stegner** concurred with **Senator Hill** regarding the inequities in the system and his recommendations and goals that the state, this committee and the Legislature ought to be attempting to achieve. **Senator Stegner** said he hoped this committee will have the opportunity to recognize some of the issues in terms of equity and fairness and the way these methods are applied across the state.

Senator Corder concurred with **Senator Hill’s** remarks as well. He said that his goal was to find ways to reduce the tax rate and arrive at a method that could reasonably and consistently evaluate the items as they come into play based on their merit and not just on what their argument is for the moment. He hopes that the outcome of these meetings will be one in which there will be a similar process put in place that can be presented to the Legislature.

Senator Heinrich also concurred with what had been said. He specifically hoped that they find exemptions that would help fund the total repeal of the ***personal*** property tax. He expressed optimism that the committee would arrive at a favorable option to consider.

Senator Siddoway said that he was concerned about equity and fairness. He is open minded to any ideas toward that accomplishment. **Senator Siddoway** said that he agrees with **Senator Heinrich** in eliminating ***personal*** property tax.

Senator Langhorst said he was pleased to see that both the House and Senate will be working together on these issues. There are approximately $1.2 billion of foregone revenue, or "tax expenditures" that are never given attention. Some have been on the books for decades. He commented that every year there are more piecemeal new deductions that are presented to the committees and it is hard to say "No," especially when there is not the opportunity to look at the whole picture, in the same fashion that JFAC is able to do. As this happens, the tax base is eroded which results in the balance of the burden being shifted to other taxpayers. He added that he would hope that there might be some form of reauthorization or reevaluation of past bills that had addressed tax exemptions and deductions. In any case, **Senator Langhorst** futher added, the committee may find that all of the expenditures are appropriate but he hopes that it be a conscious process.

Senator Bilyeu stated that as a former county assessor, one of her concerns has been equity and fairness and certainty. As property values have increased, it is difficult for individuals on a budget to have to compensate for their house payments increasing as their property values increase, given the realization that the assessments must be at market value.

Representative Collins said that he would hope that the result of this committee would be to continue to make Idaho's tax structure more fair and that there would not be any changes that would cause revenue to increase.

Representative Clark said that he would like to see some type of standard language developed as they address tax exemption issues. **Representative Clark** stated that he was looking forward to the presentations and hearing the other side of the tax exemption issue and hearing about good quality state revenue systems.

Representative Moyle said he was interested in the information that would be forthcoming and would keep an open mind on the process as it unfolds.

Representative Raybould stated that the information that was derived from the previous interim committee on tax exemptions had been very interesting. The first seventeen exemptions that were granted when the first sales tax law was put into effect were as valid today as they were then. They are the basis of the needs of our communities. However, he said that the next sixty-three have been added on consecutively. In numerous cases, a sales tax exemption would be added for a charity in order to be fair to an already granted exemption for a charity. **Representative Raybould** believes that the additional sixty-three exemptions are the ones that should be reviewed. He also stated that even though there were no recommendations made to the Legislature from the previous interim meetings that required changes, there was a lot of thought and consideration given to the issues and the process and now this committee may be a culmination of that effort that has already begun. **Senator Hill** commented that he also believes the efforts of the previous committee on this issue would be helpful to the committee.

Representative LeFavour said that generally there is a goal in mind, whether it be economic benefits to the state or something else. She believes that there needs to be some form of accountability, mile markers. Regarding nonprofits, there are also goals in mind in that area as well. She believes, for example, that a consistent state policy could be created as it relates to nonprofit sales tax exemption.

Representative Killen said that in looking at this picture, possibly a more appropriate approach would be to consider how much the state can afford to exempt; possibly some sort of cap should be considered. “Are we leaving too much on the table, or are we taking too much off?” One of the biggest complaints he has received has been regarding the disparity of property tax, “right or wrong,” as perceived by people. He believes that if information were made available on actual sales, as some sister states practice, that the effort in achieving fairness and equity could be advanced.

Mr. Ron Snell, Director, State Services Division, National Conference of State Legislatures, was introduced to discuss sound state tax systems. His complete PowerPoint presentation is available at the Legislative Services Office. **Mr. Snell** said that Legislators concerned with the long-term viability of state tax policy need to be aware that they are operating in an economic, or global climate that makes this job more difficult than it was for their predecessors twenty years ago.

Mr. Snell said that consumption patterns have shifted away from goods to services. The share of personal consumption, which the sales tax is levied by, is shrinking as a share of income. Consequently, the sales tax is levied on a proportionately smaller base which makes the question of exemptions all the more pressing. **Mr. Snell** said that income patterns are also changing. There is a trend nationally that a smaller share of personal income comes from the wages, salaries and investment returns that are taxed, and more of it comes from transfers and nontaxable kinds of income. The business taxes have become an extremely difficult issue for all states because of the complexity of business organization and the nationalization and international character of business activity which makes the old state corporate income tax a more difficult kind of tax to sustain.

Mr. Snell referring to Adam Smith’s <u>Wealth of Nations</u>, said that the basic principles of good taxation are equity, explicitness, simplicity of compliance and economy of administration. **Mr. Snell** said that the principles he would be addressing were similar to the form drafted by an NCSL task force (National Conference of State Legislatures), first in 1985 and revised by a task force that included legislators and staff and members of the private sector in 1992. A copy of the draft entitled "Principles of High-Quality State Revenue System" is available in the Legislative Services Office along with a complete PowerPoint presentation.

Mr. Snell highlighted the following principles of a "High-Quality State Revenue System."

1. A high-quality state revenue system considers state and local government needs together.

■ Issues that must be considered include:

- Role of the property tax in state-local finance. Consider what the revenue-raising capacity of property tax is as well as its burden on the people.
- Costs of state mandates on local governments.
- Fiscal capacity of local governments. Local government's ability to tax is highly variable. Great inequities in a state could exist with the ability of the local government to raise the money to support the level of services that have been dictated.

2. A high-quality state revenue system produces revenue in a reliable manner as characterized by stability, certainty and sufficiency.

■ "Stability" refers to predictable and steady growth of tax collections over time. No state tax system can be entirely stable since it depends on the economic activity of the state, which is cyclical.

Mr. Snell explained that stability can be imposed by a variety of taxes. The advantage of taxing through three main taxes, which is used in Idaho, is that you are tapping very different forms of economic activity. He stated that broad-based taxes help provide stability. It has been conventional wisdom that the best kind of tax policy is broad-based taxes with low rates. Broad-based taxes with few exemptions, deductions, and exclusions make lower rates possible. Lower rates reduce economic distortions that high rates can cause.

■ "Certainty"refers to the number and type of changes in tax law.

Mr. Snell explained that fewer changes make it easier for individuals and businesses to plan. Stable tax bases contribute to certainty. Broad-based taxes with relatively few exemptions and deductions, and low rates add to certainty because they are productive and help to flatten the economic and revenue cycle.

- “Sufficiency” refers to the adequacy of revenues to provide the services the voters expect.

Mr. Snell noted that the nature of state tax systems is that revenue growth in every state is slower than the rate of state economic growth.

3. A high-quality state revenue system treats individuals fairly by taking horizontal and vertical equity into account.

- Horizontal equity refers to the idea that people with similar incomes should have similar tax burdens. **Mr. Snell** noted this has not been a controversial issue.

- Vertical equity refers to the distribution of tax burdens among people with different incomes.

Regarding vertical equity, **Mr. Snell** said that some would argue that a high-quality revenue system should be proportional, where taxes account for the same proportion of income as income rises or progressive, where taxes account for a higher proportion of income as income rises. **Mr. Snell** noted that state tax burdens tend to be more toward proportional than progressive because of the importance of sales tax, consumption tax and property tax in the state.

Representative Lefavour asked at what point the tax burden for low-income individuals would be bumped over to the state and if there was a philosophy that deals with a consequence of this in relation to the overall costs to the state. **Mr. Snell** said that he was unaware of any broad-based philosophy. He said that states have tended to reduce the tax burden on low-income people as well as those in high-income brackets. He believes there is a general sense of fairness among states.

5. A high-quality state revenue system facilitates taxpayer compliance through avoiding complications and complexity as much as possible. It should be designed to be simple to administer, efficient, and uniform.

Mr. Snell said that these points also argue for a relatively broad base with few exemptions and deductions and relatively low rates. The simpler the structure is, the less inducement there is for people to look for exemptions and the less incentive to try to evade taxes legally.

6. A high-quality state revenue system takes interstate and international tax competition into account. At the interstate level this affects both individuals and taxes.

Mr. Snell said that one of the concerns for several states in recent years has been taxation on people over 65 years of age with the goal of keeping retirees from moving out of state. Population loss is not an issue in Idaho. But for the Dakotas, Iowa, Minnesota, Wisconsin and the New England states, it has been, as the prosperous elderly move to other states. States have substantially reduced income taxes on people over 62 or 65 years of age with the hope of retaining them in the state.

Regarding the issues of the sales and use tax and the corporate income tax**, Mr. Snell** posed the question, “Is it true that businesses move to states with low taxes...and avoid states with high taxes?” “How serious is sales tax competition across borders?” Some states that border one another will have competition, other states such as Hawaii and New Mexico will have none, aside from what is posted by the internet and catalog sales.

7. A high-quality state revenue system minimizes its effect on taxpayers’ spending decisions or alternatively has explicit reasons for affecting taxpayers’ economic decisions.

Mr. Snell said that in their 1992 task force review, this was the most difficult point upon which to find agreement. At the time, the issue was tobacco taxes. He said that if you take this policy literally of not affecting peoples’ economic decisions, there is no justification for tobacco taxes above a very minimum level. However, states have raised taxes to very high levels as a way of discouraging consumption and providing revenue. This principle is counter to what most legislators think is good policy; reducing tobacco consumption through the use of taxes because it directly affects peoples’ economic decisions, which is the reason for the second line, “unless you have an explicit reason for making such a decision.”

Mr. Snell stated that the real consequence of this principle is with broader kinds of economic behavior; for example, states that have tax breaks for businesses to create new jobs or encourage them to move into the state. Experts believe this is not good tax policy because it discriminates against businesses in the state. It is very difficult to prove that tax policy affects business decisions. It can have a very significant effect on state tax collections. The recommendation is not to tax on a case-by-case basis, but tax across the board; like your corporate income tax be at very low rates, that other kinds of taxes on businesses be at very low rates so that they do not serve as an impediment to business decisions.

Representative Raybould asked how other states deal with the Indian reservations with regard to tobacco, gasoline tax, and other items that cause unfair competition with the surrounding communities? **Mr. Snell** said that he is not familiar with this issue, but some states have been attempting to establish compacts so that they can reach an agreement with the Indian tribes on how items should be taxed and try to reach limits on to whom the Indian tribes can sell motor fuel and tobacco. **Mr. Snell** said he would provide additional information on this subject.

8. A high-quality state revenue system needs to be accountable to taxpayers.

- Taxes and tax preferences should be explicit.

Mr. Snell said that tax preferences should be explicit especially on behalf of businesses. He said that

Kansas and Oklahoma passed legislation calling for transparency in state budgeting, which calls for a precise and detailed posting on the state's website of every kind of state expenditure. This expenditure explicitly includes tax preferences on behalf of citizens and businesses. The Chamber of Commerce in Oklahoma immediately responded by asking the Governor to veto the bill. **Mr. Snell** said that this would kill the possibility of business moving into the state. The goal of the legislation was to move in the direction of accountability/transparency, recording everyone of these preferences and expenditures.

- Tax expenditure budgets are a form of transparency.

Mr. Snell said that tax expenditure budgets indicate what each exclusion or deduction costs. This is a way of reporting them in a public fashion. Every form of transparency is somewhat controversial because the recipients of deductions and exclusions do not always want the information open to the public.

Senator Stegner asked if he had heard **Mr. Snell's** comment correctly that businesses do not generally make decisions based on individual state tax policies. **Mr. Snell** said that is what he said and it is based on the consensus among economists who study that issue. As a general principle, it cannot be established that tax concessions will bring a business to a state in preference to another place. **Mr. Snell** added that the thinking behind that is that other questions affect location decisions far more than taxes; the availability of labor, the cost of location, the availability of sources as markets. State taxes play so relatively small a role in the economy of most businesses that the other considerations on location decisions are much more significant.

Senator Stegner commented that there may be a few in the audience that would disagree with that analysis and asked if **Mr. Snell** had any definitive studies that had been done that would demonstrate that position. **Mr. Snell** said that "happily for the economists" there has never been a definitive study where there has been full agreement on this issue. **Mr. Snell** said that he would be happy to provide references on reliable studies. He commented that he agreed that this is a point that invites disagreement as well.

Senator Corder asked, given the global nature of our economy, if **Mr. Snell** would comment on the question of how businesses are making that decision; and how a minute part of that decision is a state's tax concession, given that businesses more frequently are making decisions based on a global basis rather than a state or regional basis. **Mr. Snell** said that American competitiveness is going to depend on extremely intelligent and clever use of what we have. Maintaining economic growth in the United States requires an extremely astute, inventive, creative use of our resources. Some organizations would claim that what the U.S. needs to do instead of focusing on the tax issue, which is a highly controversial and endless dispute, is focus on questions of education and removing barriers to innovation and making sure there is a population prepared for dealing with new ways of doing things; and that to the extent you can provide this through education.

Senator Hill commented that the Senate Committee during the last legislative session had a conference meeting with a number of high level officials of Hewlett-Packard from Washington, D.C. They basically took a similar position that tax incentives were not something they necessarily looked at when making decisions regarding location. However, tax stability was a factor to the extent that the Legislature was not always changing the tax system, and asked **Mr. Snell** to comment. **Mr. Snell** said in their panel discussions, the relative level of state taxes was a minor consideration for a company like Hewlett-Packard in most states. The greater concern was the level of stability and simplicity. They would prefer not to be completing dozens of tax forms daily as is the case with AT&T in states across the country. They would prefer to have a certainty of knowledge about what will be coming to them in the future.

Representative Langhorst asked whether **Mr. Snell** was aware of other types of incentives that are provided for areas like the Silicon Valley in California that have a concentration of high-tech industry where their inputs are labor, engineering and software. **Mr. Snell** answered by giving an example of North Carolina, which years ago was a low-income state with a much lower population, and low level of education, other than its two premier institutions in Durham. In the 1970's the General Assembly and the Governor made the conscious decision that the future of North Carolina lay with education and worked consistently over the decade to strengthen the quality of public schools, on through to the universities and providing them with a foundation to move into a technological future and then providing the facilities that have become the research triangle at Durham, Chapel Hill and Raleigh, which is a center similar to the Silicon Valley.

Mr. Snell mentioned another example which was Eastern Massachusetts, the earliest center of high-tech industry in the United States. It existed because of the concentration of very skilled and highly educated people. **Mr. Snell** commented that he believes that you have to get at the issue through spending policy, not tax policy.

The committee recessed at 10:30 a.m. and reconvened at 10:45 a.m.

Dr. Stephen C. Cooke, Associate Professor, Department of Agricultural Economics and Rural Sociology, University of Idaho, was the next speaker. His complete PowerPoint presentation is available from the Legislative Services Office. **Dr. Cooke** said that he was not speaking for the University of Idaho or the Department of Economics, but his comments and ideas were his own opinions. He said that he would be focusing on business taxpayers and good tax policy with regard to tax exemptions and economic development.

Dr. Cooke outlined a scenario of a high transaction cost location decision of a prospective Fortune 500 company moving into an area. He referred to a book entitled "Reining in the Competition for Capital." A copy of which is available in the Legislative Services Office. One of the authors, Timothy J. Bartik, pointed out that we live in an age of falling transportation and communications costs reflecting global realities.

Mr. Cooke said that to compound problems associated with outsourcing and globalization, you have the rise of site consultants. These are professionally, high-powered, trained site location consultants who travel across the country whose business it is to extract rents from local governments in order to provide sites for local businesses. He said that some of the authors in the above mentioned book believe this is probably the key problem that is causing this demand for exemptions.

Dr. Cooke explained that another problem, as pointed out in the book, is that firms have rent seeking behavior. They are not just interested in producing a good or service, they are also interested in extracting rent from local governments. **Dr. Cooke** summarized that, given there is rent available, two groups are vying for it, and who wins and who loses is not exactly determined. The object of the game is to maximize rent and that is what the business is after.

Senator Hill, for a point of clarification, summarized that the company wins if they negotiate a low price, and the city wins if they negotiate a high price. **Dr. Cooke** answered by saying that the city really wins if they negotiate the high price, but the city breaks even if they negotiate at a point where average cost equals average revenue. If they negotiate a low price, then they have to charge someone else in order to cover cost.

Senator Stegner asked if the city gives up rent or gives up services to a business to attract it, does everyone else, already in the community, have to pay the difference? **Dr. Cooke** said that that was exactly right, if the business pays less, someone else has to pay more. It may also be at another level such as the state, the county or federal.

Representative Raybould commented that we are continually being bombarded by business interests that contact us and say that if we can give them a certain tax break, they will bring in a certain number of people, and will require a certain amount of other business services which will actually increase our revenue. He asked if this scenario holds true and revenue of a city is actually increased by the additional business and new people moving in.

Dr. Cooke referred to a study done by Gabe and Kraybill in 2002 of 366 Ohio firms who expanded from 1993 to1995.They found that in order to increase capital incentives, firms have a reason to over announce the number of jobs they plan to bring to the community. They found that firms that received capital incentives over announced jobs but actually created no new jobs. In fact, capital incentives to firms led to fewer jobs. Firms that received no capital incentives actually expanded and created new jobs.

Senator Hill commented that this was counterintuitive. **Dr. Cooke** commented that this is what makes this problem so interesting and "mind-boggling" and complex. He remarked, "To answer

Representative Raybould's question, "If you are not creating new jobs,... you are not going to get the multiplier and you are not going to improve the economy. This is just the irony of ironies."

Representative Lefavour asked if the trend of mobility of some of the larger companies was characteristic of certain types of companies, for example retail versus manufacturing. **Dr. Cooke** referred to his PowerPoint presentation illustrating a study based on the structure of employment in Idaho in 2001 and 2005 that was conducted by a graduate student. The study separated what was happening to wages and to jobs by annual wage category. Relative to retail, the findings showed that general merchandising jobs have been increasing, but their wages are actually falling. **Dr. Cooke** suggested that if you are going to provide incentives, that you provide job incentives to encourage employment instead of capital investment.

Dr. Cooke addressed the sales tax issue. The place with the best wages has the fewest number of jobs. Most of the jobs are in the service sector not in producing goods. The good wages are in the goods producing sector. The goods sector is taxed whereas the service sector is not. "We save the low-wage jobs and we lose the high-wage jobs. **Dr. Cooke** referred to a graph to illustrate his point that "you're paying dearly... for having services exempt from the state."

Randy Nelson, **President, Associated Taxpayers of Idaho**, was the next speaker. His PowerPoint presentation is available from the Legislative Services Office. **Mr. Nelson** presented three points on tax policy and how it works:

- With federal state and local governments acting independently, it is challenging to have a tax policy especially when the economy fluctuates; and when intergovernmental services, mandates and funding responsibilities cause changes and shifts.
- Tax policy seems to be a phenomenon created by a series of events. With changing economic conditions, there is the ability of government to adjust its scope, size and reach to provide public services. Also, there is increasingly, government's ability to tailor its tax code and respond to changing economic conditions.
- The future is uncertain and thus consequences of tax policy measures are equally uncertain.

In addition to the "Guiding Principles of Good Tax Policy" referred to by **Senator Hill**, **Mr. Nelson** referred to a study done by the American Institute of Certified Public Accountants in 1993, called the Tax Complexity Index Study. The study provided fifteen questions and a rating system for the purpose of assessing the relative objective complexity or simplification of a proposed tax law change. **Mr. Nelson** said that some of the subjective types of questions always need to be asked, for example, can the objective of this change be achieved more simply? Do the benefits of this change outweigh the cost? Does the simplification achieved lead to substantial unfairness? Has it been given adequate hearing and debate? Is the statute clearly written and logical? **Mr. Nelson** said he would make the information available to the committee upon request. He added that principles can vary depending on the case of each entity.

Regarding vertical and horizontal equity, **Mr. Nelson** pointed out that for those who have the ability to pay more, the question is how much more, which is a topic of debate. Regarding progressiveness, the entire range of taxes needs to be considered.

Mr. Nelson referred to the emerging concerns that affect tax principles:

- The evolution of fiscal federalism; Congress has delegated increased responsibilities to state and local governments.
- Pressures on state revenue systems; escalating costs of Medicaid, health care, corrections, education, and other programs.
- The changing nature of state revenue systems; pressure to limit or reduce property taxes substituted with income and sales taxes.
- Intensified interstate and international economic competition.

Mr. Nelson presented a history of property, income and sales taxation in Idaho that had been prepared by the Association. This is included in his PowerPoint presentation available from the Legislative Services Office.

Mr. Nelson explained how the tax system has changed from 1945 to 2006 by using selected state and local tax collection figures. He summarized the dollar amounts collected from state and local taxes in various years during that span of time. He noted that in 1945, $6.8 million was collected from state taxes compared to local taxes of $17.6 million. By 2006 the reverse was true, the amount of taxes the state collected was $2,484.5 million which was about twice that collected from local property taxes in 2005, which was $1,239.1 million. The introduction of the sales tax in 1970 and the increase in individual income tax and corporate income tax has contributed to the substantial increase in state tax collections. (See PowerPoint presentation for further detail.)

Senator Hill asked if any of the changes were made by taxpayer initiatives other than the homeowner's exemption; for example, the 3% budget cap. **Mr. Nelson** said that the changes were accomplished legislatively.

Mr. Nelson highlighted the major Idaho credits, deductions, exemptions and exclusions.

- *Income Tax*: this group totals approximately $240 million in deductions.

- *Sales Tax*: production exemption on equipment and supplies; goods not taxed (motor fuels and utility sales such as natural gas, electricity, water); services not taxed (construction, information, repairs, professional health and medical and social). The total is approximately $1.6 billion.

- *Property tax*: homeowner's exemption; speculative value exemption, agriculture equipment; pollution control exemption, etc. The homeowner's, speculative value, and pollution control exemptions have a value of approximately $40 billion dollars. A value has not been placed on the remaining exemptions in this list.

In response to a question from **Senator Hill**, **Mr. Nelson** said that the $40 billion was in property value. He estimated that a tax estimate value placed on the remaining exemptions might total about $250 to $300 million.

Mr. Nelson included information on how Idaho ranks with other states in comparing state and local taxes and expenditures. The latest figures were from 2004 since 2005 has not yet been compiled. He noted Idaho ranks 27th in total state and local taxes on a per $1,000 income basis. (See PowerPoint presentation for a complete list).

Mr. Nelson presented a study done by the District of Columbia which is a nationwide comparison of family tax burdens in 2004. He said that he had selected a range of family incomes from part of the study and indicated how Idaho ranked within each of the following income levels. Income, property, sales, and automobile taxes were the key taxes that were considered.

Family Income=	$25,000	$50,000	$75,000	$100,000	$150,000
ID Rank (50 Sts/DC	45th	34th	27th	25th	19th
Total Tax	1,222	3,670	6,857	9,595	14,984
Percent of Income	4.9%	7.3%	9.1%	9.6%	10.0%

Regarding the progressivity index, **Mr. Nelson** said that Idaho ranks 4th highest in our tax system. The major cities in South Carolina, New Orleans, Louisiana, and New York rank higher. Seattle, Washington ranked 48th and Las Vegas, Nevada ranked 51st.

Mr. Nelson noted a list of future tax policy issues that may be forthcoming. This information is available in the Legislative Services Office.

In response to a question from **Senator Langhorst** regarding how Idaho ranked with other states, **Mr.**

Nelson said that our incomes are lower in comparison to other states. For example, Idaho ranks 46th for per capita personal income.

Senator Bilyeu asked **Mr. Nelson** to explain more clearly the progressivity index and why we are behind New Orleans and the other cities. **Mr. Nelson** said that the method that is used in the report is that they look at the lower-end family income, or $25,000 and its percent of income in tax, or 4.9%; then they look at the higher income, or $150,000 and the percent of income taxed, or 10%. They then raise the progressivity for each state by dividing the low end by the high end. For Idaho 4.9% is divided by10.0% which equals a factor of 0.489 which is equal to the 4th highest tax system index. **Mr. Nelson** noted that Idaho has a very high income tax rate. He further noted that in many cases, in the lower-end income levels, the family probably doesn't have an expensive home and are able to benefit more from the homeowner's exemption. In higher family incomes, homes are usually more expensive and the homeowner's exemption will not be as much of a benefit.

Representative Killen, referring to the above tax burden comparisons, asked how the figure for property tax of $527 listed for a family income of $25,000 was determined. He added that some families in his district don't even own a home. **Mr. Nelson** said he was not sure of all the factors that were included. He suggested that possibly a home may have been inherited. **Senator Hill** suggested that there are possibly many retired couples with very low-income levels that still own their home.

In response to a question from **Representative LeFavour** regarding income rates in comparison with other states, **Mr. Nelson** said that Idaho's rate is 1.6% on the first $1,198 in 2006. The next $1,198 is taxed at 3.2% and continues until it reaches 7.8% for the single income taxpayer at $23,963. Anything above that remains at the 7.8%. **Senator Hill** responded by saying that, in his business many tax returns are filed in various states. His experience has been that Idaho is more compressed as far as their brackets. Idaho hits the top income bracket at a lower income level than most other states. He added that other states usually have a top bracket that kicks in for a normal taxpayer and remains at that rate for any income after that. The 7.8% is fairly comparable to other states.

Representative LeFavour asked if she was correct to assume that everyone in this study was paying the same rate of tax. **Senator Hill** said that was not correct because those with incomes of $25,000 are not paying any tax because of the exemptions and deductions they receive. Consequently, the lower incomes are paying a lower rate as well as the exemptions and deductions being a higher percentage of their income. **Senator Hill** noted that these progressive rates are not retroactive. Only the amounts that go over a certain income are taxed at the 7.8%.

The meeting recessed at 12:12 P.M. and reconvened at 1:30 P.M.

Dan Chadwick, **Executive Director, Idaho Association of Counties,** was the next speaker. His complete PowerPoint presentation is available at the Legislative Services Office. **Mr. Chadwick** stated that the counties do not set policy at the local level as some people may think. Counties administer the property tax system at the local level. They do not make decisions on market value other than to achieve market value. They have to actually find the market value and present it to the property owner as closely as they can. He said that this is sometimes difficult for the Legislature and the public to understand. **Mr. Chadwick** stated that if the county does not find market value, the state tax commission will order them to either physically appraise the property or trend it, or they will do it for them. If the county does not comply, the state will take away sales tax dollars until it is accomplished. Consequently, the rules and standards have been set for the counties who are required to respond.

Regarding expenditures, **Mr. Chadwick**, said that they do not have a lot of discretion. With regard to counties, unlike cities, in the cases of the indigent, juveniles, courts, law enforcement, jails, etc., there isn't a lot of 'wiggle room' in terms of how they spend dollars. He remarked that most county officials would agree that the most fundamentally fair system would be a system where you achieve market value with no exemptions. However, it is a known fact that exemptions are used to achieve certain results. **Mr. Chadwick** referred to the Title 63 list of exemptions from taxation that was included in the packet that had been given to the members. The packet /PowerPoint presentation is available in the Legislative Services Office.

In addressing the issue of altering the burden of property taxes, **Mr. Chadwick** highlighted some specific points regarding exemptions using a practical scenario:

- Exemptions grant relief to a particular type of taxpayer based on ownership or use in terms of government, religion, etc., nonprofit, educational, agricultural equipment, etc. **Mr. Chadwick** commented that they do not know what those values are, which is a key component that is missing.
- An exemption may be funded by the state if the state replaces revenue; similar to the M&O of last year. **Mr. Chadwick** said that if an exemption is granted for personal property tax, then potentially state revenue will be used to fund it, i.e., replacement revenue.
- If an exemption is not funded by the state, taxes will shift to other taxpayers.
- The Exemption Spiral – Exemptions drive up levy rates. **Mr. Chadwick** explained that because the base is lower, the rates have to be raised to make up the difference in revenue. Exemptions lead to higher property rates, which in turn result in new pressure for exemptions, which in turn create new pressure for higher rates.
- Tax Shifting Through Exemption – **Mr. Chadwick**, by using a hypothetical example, illustrated how the creation of a new exemption would lower the base and in turn require the levy rate to increase, which would in turn cause the taxes to increase. (See to the PowerPoint presentation.)

In closing, **Mr. Chadwick** commented that county government does not set policy, they are administrators and carry out the policy of the state at the local level.

Representative Lake, regarding Craig-Wyden dollars that are awarded to specific counties with large timber standings, asked if this hasn't just been extra money that has flowed into those counties. **Mr. Chadwick** said, "No." The counties that received Craig-Wyden money did not levy because they were receiving a large amount of those dollars. Valley and Shoshone counties are good examples. Upon losing those dollars, they now have no ability to levy to replace the dollars. They are not surplus dollars. **Representative Lake** asked if their levy rate is substantially lower than what might be found in "flat land" country. **Mr. Chadwick** said that is probably true in some circumstances. **Representative Lake** asked if it was safe to say that the property tax burden is lower in those counties with a high incidence of Craig-Wyden money than it is in other counties. **Mr. Chadwick** said that without looking at the bottom line it could be, but there could also be other factors involved.

Representative Clark asked how the counties survived pre Craig-Wyden money. **Mr. Chadwick** said that Craig-Wyden replaced timber receipt funds, the 25% funds that timber counties had received as a result of timber harvests. As the timber harvest began to decline, Congress stepped in and provided a safety net with the hope that the timber harvest would return to its original status and bring receipts back up, which has not happened yet.

Representative Raybould asked **Mr. Chadwick** to explain the difference between the Craig-Wyden and the PILT grant (payment in lieu of taxes). Craig-Wyden is dedicated for schools, roads and bridges. PILT moneys are dollars given to every county in the state and in the country that has public lands. They are used for general operations of services that counties provide. It is a payment in lieu of tax that the federal government might otherwise have paid to the locals. **Representative Raybould** asked if that was being affected by federal regulations now. **Mr. Chadwick** said they have authorization for full funding of PILT which is over $340 million nationwide. However, they are only at about $240 million in terms of appropriation. In response to a question from **Senator Hill**, **Mr. Chadwick** said he and his associates had not had an opportunity to review the Title 63 exemptions and select which ones they felt should be excluded.

Representative Killen asked if information on actual sales would be beneficial to the counties. **Mr. Chadwick** said that has been an issue that they have asked for for several years. He said that if they are obligated to determine market value, the question they've always had is, "How can we do it if we don't have the tools?" The issue of full disclosure and sales price disclosure is one of the key elements of determining what market value is. It is not the end-all. However, it is one of those critical elements that would help the county assessor determine market value.

Mayor Garrett Nancolas, **City of Caldwell** was the next speaker. **Mayor Nancolas** introduced **Mayor Nancy Merrill, City of Eagle** to address the committee as well. **Senator Hill** expressed his appreciation to both mayors for being there on such short notice. **Mayor Merrill** stated that tax exemptions are difficult for cities throughout the state because they don't set those and do not have tools to be able to provide incentives for businesses or others coming into their communities. She provided a packet of information reflecting city budgets and levy rates which is available in the Legislative Services Office.

Mayor Merrill said that much of the general revenue for their cities is from intergovernmental or property taxes; the latter only 12% of their budget this year. She said, "Most of the cities across the state of Idaho with the small levy rates that we have and the cap, do not have an increase of taxes...property taxes out there is a burden on that even with high market values." She said most of the city's revenues go into services, employees, and to running the city. Some of the funding is received from permits and fees.

Representative Lake asked if Eagle was locked into a very low levy rate because of being very conservative in years past. **Mayor Merrill** agreed that they are locked into a very low rate and it is the third lowest in the state, and yet they have some of the highest market values. This past year their levy rate was 0.00087%.

Mayor Nancolas addressed the committee. He provided a handout entitled, "Tax Policy Perspectives, Association of Idaho Cities," copies of which are available in the Legislative Services Office. **Mayor Nancolas** said that cities and counties are extremely different in the way they have been directed to function. County issues are set by state policy and statute. Cities have the right to govern somewhat differently. Some cities provide different services than others depending on what their charter is. Some cities provide police and/or water and sewer, and others do not.

Mayor Nancolas said that funding sources for cities are very restricted. There is not a lot of flexibility for creating ways to raise revenue. He said that Caldwell's budget last year was approximately $54 million for all of the services they provide, which are most of the gamut of services. He said there are two types of funds that cities can use, proprietary funds, or enterprise funds, such as the golf fund, sewer and water fund, that are expected to provide enough revenue to provide for their own expenses, and the general fund. The funds that they have that are flexible are those that come into the general fund. The total general fund last year was approximately $18 million and of that $7.8 million were property taxes. Of the $7.8 million, 98% of those property tax dollars were spent on police and fire. Cities don't have a lot of flexibility with grants or enterprise funds.

Senator Siddoway asked **Mayor Merrill,** with the 3% limitation they have to budget for, how would it be possible to purchase, for example, a fire engine or build a new sewage treatment facility? She said they have to be very creative.

Mayor Nancolas added that another important point was that the other part of the taxing process, especially in communities that are growing rapidly, is that the cost of providing services escalates dramatically. They strive to have new growth and development pay for itself. This is accomplished by being able to take the value of annexations and new construction on their rolls. In order to stay up with the cost of services, the city of Caldwell had to take the 3% increase every year because they were not growing.

Senator Hill asked if there were provisions in the law that will let the people vote for more than a 3% cap and particularly for Mayor Merrill, having such a low rate, has that been attempted and are their provisions for overriding that law for hardship cases where Eagle's rate is particularly low compared to the state and asked what those processes were. **Mayor Merrill** said that there is a process by state law that allows them to go to the people for a vote to raise their taxes. Historically, there has only been one city, Soda Springs, that was able to pass that type of a levy. They could do it, but the probability of getting it passed is very slim.

Senator Hill invited discussion from the members.

Senator Bilyeu said that in reviewing the information presented so far, it seems that there has not been a lot presented about income tax, but more about sales and property tax. She wondered if there should be goals to limit exemptions and if so should they focus on each tax category separately. **Senator Hill** said that prior to the meeting, he and **Representative Lake** made the decision that when the committee began making recommendations, they would address one tax at a time, which will probably take place in the meetings in October. He said that there are no presenters planned in October unless a member or someone specifically makes a requests. The majority of the time will be spent on sales tax where there are the largest number of exemptions. Income tax will be the next category and the least amount of time will probably be spent on property tax because there are very few exemptions under that tax. But that will be guided by the committee.

Representative Killen said that at the outset of the last session, the Tax Commission provided an overview that itemized their estimates and what each of the exemptions and credits represented. He asked if that would be updated and made available for the members. **Dan John**, **Manager, Administrative Appeals, Idaho Tax Commission**, said that he would make copies available at the next meeting. The document has been updated and extends to 2010. In response to a question from **Senator Hill**, **Mr. John** said that it looks at every exemption and income tax as well as sales tax and always estimates the service component.

At **Senator Stegner's** suggestion, the committee discussed changing the meeting dates in October. **Representative Lake moved to change the dates to October 1, 2 and 3, 2007. Representative Clark seconded the motion**.

The motion passed without objection.

Senator Stegner commented that he would like this committee to spend a little time discussing the personal property tax issue and consider the possibility of this being a starting point to be revisited in the next legislative session. He suggested that this be one of the discussion items for consideration at the October meeting. **Representative LeFavour** commented that she would like part of the discussions on personal property tax to include consideration given to what other tax options could be offered to the business community that they and the Legislature would consider appropriate and fair in the event of replacing one form of tax with another might become an issue. **Senator Stegner** commented that one of the concerns that he has had, as well as others in the Senate, with regard to the personal property issue, was replacement moneys. He agreed that this is probably the most critical issue. **Senator Hill** agreed that such discussions would be appropriate.

Chaiarman Lake moved that any action from this committee in the form of a recommendation would require a 2/3 vote of the committee. He explained that the reasoning behind this action is that if the committee is dealing with a change in current policy or current law they should have a good strong majority if they are going to make any recommendations. In response to a question from **Representative Killen**, **Senator Hill** said that the motion is referring to any recommendations they make to the Legislature. **Representative Lake**, responding to the question, pointed out that **Senator Hill** had stated that the committee can adopt this by a simple majority, as well as undo it by simple majority, if desired, down the road. **Senator Hill** had received confirmation from **Jeff Youtz, Director, Legislative Services**, who confirmed that setting ground rules and making a motion requiring a 2/3 vote is allowed, as well as making a motion to undo the 2/3 requirement could be made with only a simple majority.

Committee discussion on the motion followed.

In response to a question from **Senator Bilyeu**, **Senator Stegner** said that in the sales tax exemption interim committee that met four years ago, there were no suggestions or alternatives that were supported by the majority of the committee and nothing was passed. **Representative Raybould** added that he was on that committee and there were no recommendations made. However, he said there was a majority report and a minority report of the results that were provided to the Legislature.

The motion failed by 8 Nays and 6 Ayes.

Senator Hill remarked of the great number of exemptions that the committee would have under consideration. He asked the members if they would take some time to review the exemptions by the Friday meeting and possibly narrow them down to those considered to be the most important. He suggested rating them by the order of importance. **Dan John and Mike Ferguson**, **Division of Financial Management,** both agreed with **Representative Lake's** request to be prepared to address the committee August 2, the next day, instead of August 3, since the timeline for the agenda was moving more quickly than projected.

The meeting was adjourned at 2:45 P.M.